



Port of Newcastle Determination

4 April 2024

This information paper accompanies our determination of the relevant compensation under the *Port of Newcastle (Extinguishment of Liability) Act 2022* (the Act).

This information paper details:

- what we were required to do for this review
- the information we used
- the methodology we developed to calculate the relevant compensation
- the impact of the payment of the relevant compensation.

Overview of the Determination

In 2013, as part of the process to privatise Port Botany and Port Kembla, the State of NSW (the State) entered into an agreement to compensate NSW Ports, the winning bidder for Port Botany and Port Kembla, if certain conditions related to container traffic at the Port of Newcastle are met. Separately, in 2014, as part of the transaction to privatise the Port of Newcastle, the winning bidder for that transaction agreed to reimburse the State for any compensation that is payable to NSW Ports.

On 2 March 2023, IPART was appointed to determine the value of a one-off compensation payment that can be made by the Port of Newcastle to the State to remove the Port of Newcastle's liability to make payments under these arrangements. This one-off payment is known as the relevant compensation.

We have determined that the relevant compensation is \$10,120,000 in 2014 dollars. Adjusted for changes in the Consumer Price Index (CPI) between June 2014 and December 2023,^a this payment is \$13,006,000.^a

^a Section 5 of the *Port of Newcastle (Extinguishment of Liability) Regulation 2023* details the adjustment to be made to the relevant compensation, to account for inflation (changes in the Consumer Price Index) between the June quarter of 2014 and the date of payment.

The Act provided specific direction for how the relevant compensation amount is required to be determined. It requires IPART to calculate this as the amount that a reasonable person bidding for the right to operate and lease assets at the Port of Newcastle in 2014 would have reduced their bid by as a result of the requirement to reimburse the State. As a result, we were limited to information that was known or could have been known at that time.

Separately, the State remains liable to pay compensation to NSW Ports, if certain conditions are met, including if container trade at the Port of Newcastle is above a specified annual threshold. The value of this compensation was not a matter that we could consider when determining this one-off payment. The amount of compensation payable by the State to NSW Ports is calculated annually based on the actual container throughput occurring at the Port of Newcastle, an annual container trade threshold and the prices for container trade at Port Botany and Port Kembla.

As of April 4 April 2024, the State has not been required to pay compensation to NSW Ports. If compensation is required to be paid, the compensation payable by the State to NSW Ports will reflect developments that have occurred since 2014 and will continue to occur over the full 50-year period of the agreement between the State and NSW Ports (for example, changes in supply chains, new technology and population growth).

As the amount of compensation payable by the State to NSW Ports will reflect a range of developments since 2014, it may be significantly different from the one-off payment that we have determined under the Act.

The information we considered when calculating the relevant compensation

We conducted our review in line with the requirements of the Act. Section 7(1) of the Act specifically required us to consider how much a reasonable person would have reduced their bid by, as of result of the inclusion of the reimbursement provision in the Deed^b. This constrained us to considering only information or data that was available or could have been known by a reasonable person, as of the date the Deed was entered into, which was on or around 30 May 2014.

We consider that a reasonable person would have the following characteristics:

- they know the information which a bidder for the right to operate and lease the assets of the Port of Newcastle would have known or could have known as of 30 May 2014
- the person has access to professional advisers, such as lawyers, bankers and accountants, and
- the person is able to make predictions and risk assessments about the future that a bidder could have made as of 30 May 2014.

These characteristics of a reasonable person guided the information we considered when we calculated the relevant compensation. In particular, we only relied on information or data that was available or could have been known by a reasonable person as of 30 May 2014.

^b Consistent with the Act, Deed refers to the "Port Commitment Deed" entered into by the State on or about 30 May 2014 relating to the leasing of the Port of Newcastle, as in force from time to time.

How we calculated the relevant compensation

We conducted a valuation process to assess the viability of developing a container terminal at the Port of Newcastle, from the perspective of a reasonable person, if the reimbursement provision had not been in place. We conducted this valuation process for both a port operator and a stevedore.

We then compared what we consider a reasonable person would have paid for the option to develop a future container terminal at the Port of Newcastle with and without the reimbursement provision. The difference between the value a reasonable person would have paid with and without the reimbursement provision is the relevant compensation.

We assessed the viability of a future container terminal using a discounted cash flow valuation

In the absence of the reimbursement provision, we consider a reasonable person would have placed value on the option to develop a container terminal at the Port of Newcastle if, as of 30 May 2014:

- a future container terminal at the Port of Newcastle had the potential to generate an acceptable rate of return, given the risk involved, and
- they considered it was likely that they would be able to attract a stevedore to conduct future container terminal operations.

To assess whether a future container terminal had the potential to generate an acceptable rate of return, given the risk for a port operator and stevedore, we conducted a discounted cash flow valuation.

Using a discounted cash flow valuation, the value of an asset (that is, a future container terminal at the Port of Newcastle) at a point in time (30 May 2014) is estimated as the discounted value of all future cash flows, where the discount rate is the weighted average cost of capital.

In cases where an asset's estimated future cash flows are uncertain, scenario analysis can be incorporated into the discounted cash flow valuation. Using this approach, the expected value of an asset is estimated through a weighted average of the net present value of future cash flows under a reasonable range of scenarios.

We developed 4 scenarios to value a future container terminal at the Port of Newcastle. The key variable that changed across the scenarios was the forecast of container throughput in 20-foot equivalent units per year.^c These scenarios were based on forecasts of container throughput that were prepared before May 2014 or prepared using data that was available as of that date.

We also formed a view on what a reasonable person would have concluded was the likelihood of each scenario occurring. We based this likelihood on various factors, including:

- whether development consent would be provided for a container terminal at the Port of Newcastle and what the likely constraints of that approval might be
- whether a container terminal would be able to attract shipping lines in sufficient volumes

^c In addition, revenue, total capital expenditure, timing of capital expenditure and operational expenditure also varied across our scenarios. These varied in scale with the level of container throughput in each scenario.

- whether landside supply chains, including intermodal terminals and distribution warehouses, would realign to support the forecast of throughput being achieved
- the impact of a rational competitive response from stevedores at Port Botany.

Our discounted cash flow valuation found that a container terminal at the Port of Newcastle could generate a reasonable rate of return, given the risk involved, for both a port operator and stevedore. Further, our modelling indicated there would be potential to generate material returns under the scenarios with higher levels of throughput.

We estimated what a reasonable person would have reduced their bid by due to the reimbursement provision

We then estimated what a reasonable person would have reduced their bid by due to the reimbursement provision in the Deed. We did this by estimating the difference between the value a reasonable person would have placed on the right to develop a container terminal at the Port of Newcastle with and without the reimbursement provision in place.

We identified a positive net present value associated with the option to develop a container terminal at the Port of Newcastle, in the absence of the reimbursement provision. After looking at the different throughput scenarios and the probability of them occurring, we concluded a container terminal would be sufficiently profitable that a reasonable person would have placed some value in their bid, if the reimbursement provision was not in place.

However, if the reimbursement provision was in place, we found that a reasonable person would have valued the option to develop a future container terminal at zero. We concluded this by estimating the present value of payments that the operator of the Port of Newcastle would be required to pay under the reimbursement provision under the 4 scenarios. We found that if the port operator was required to make these reimbursement payments, the return from a container terminal would be either negative or negligible in every scenario.

As a result, we consider a reasonable person would have reduced their bid by an amount equal to the expected net present value of developing a container terminal at the Port of Newcastle.^d

To determine the relevant compensation amount, we estimated the net present value of developing a container terminal for each of the 4 scenarios. We then calculated the weighted average of these values using the probability weightings we had assigned to each scenario.

The result was a weighted average value of \$10,120,000 in 2014 dollars. Adjusted for changes in the Consumer Price Index (CPI) between June 2014 and December 2023, this payment is \$13,006,000. This is the relevant compensation for our determination.

^d Had the net present value of developing the container terminal been higher than the present value of the reimbursement payments, then a reasonable person would have factored some value into their bid both with and without the provision. In that case, we would have taken a different approach to determining the relevant compensation amount. The relevant compensation amount would have been equal to the present value of payments expected to be made under the reimbursement provision.

We sought submissions throughout this review

While undertaking this review, several parties contacted IPART seeking to make a submission. These parties indicated they had information that would assist IPART in calculating the relevant compensation.

We sought public submissions in June 2023

We sought public submissions in June 2023. We received 5 submissions, 2 of which claimed confidentiality and have not been published on our website. The remaining 3 submissions are on our website. The submissions proposed materially different ways to estimate, or materially different estimates of, the relevant compensation.

All of the submissions included some inputs or assumptions based on information that was published after 30 May 2014. As we were required to determine a value at the time the Deed was entered into, we excluded any information that could not have been known as of that date.

We sought submissions on the draft determination from the operator of the Port of Newcastle and the State

We provided a draft determination to the operator of the Port of Newcastle and the State in November 2023. As required by the *Port of Newcastle (Extinguishment of Liability) Regulation 2023* (the Regulation), we provided the opportunity for these parties to provide a submission in response to the draft determination. We considered information submitted when making our determination.

Timeline for the review

We were appointed on 2 March 2023 to determine the relevant compensation.

Under section 4 of the Regulation, we were required to make a determination within 6 months of the date of appointment, or within 9 months if we issued a draft determination to the operator of the Port of Newcastle and the State. We could extend this period by another 6 months if additional time was required.

In August 2023, we notified the Treasurer and the operator of the Port of Newcastle that additional time would be required to complete the determination.

We provided the draft determination to the State and operator of the Port of Newcastle in November 2023. The final determination was required to be provided by 2 June 2024.

Impact of the payment of the relevant compensation

Under section 8 of the Act, if the operator of the Port of Newcastle pays the relevant compensation, adjusted for inflation to the State, from that date the reimbursement provision in the Deed has no legal effect.

¹ Australian Bureau of Statistics, *Consumer Price Index Australia, Tables 3 and 4. CPI: Groups, Weighted Average of Eight Capital Cities, Index Numbers and Percentage Changes*, released 31/01/2024, accessed 27 February 2024